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Supreme Court of the United States

OCTOBER TERM, 1948

No. 168

THE CITY OF NEW YORK, PETITIONER,

vs.

LEWIS H. SAPER, AS TRUSTEE IN BANKRUPTCY OF SPOTLIGHT PRODUCTIONS, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED JULY 21, 1948.

CERTIORARI GRANTED OCTOBER 11, 1948.

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

In the Matter of SPOTLIGHT PRODUCTIONS, INC., Bankrupt; LEWIS H. SAPER, as Trustee in Bankruptcy of Spotlight Productions, Inc., Appellant; LAZARUS JOSEPH, as Comptroller of The City of New York, Appellee

STATEMENT UNDER RULE 15(b)

This appeal is taken by permission of this Court granted on January 5th, 1948. It involves a review of an order made by the District Court allowing a tax claim filed by the Comptroller of the City of New York.

The Comptroller filed a tax claim with the Referee in May, 1944.

The Trustee made a motion to expunge the claim on July 1st, 1947. Thereafter, the City amended its claim, subject to the same objections. Following a hearing before Referee John E. Joyce, the objections were overruled. Upon petition to review to the District Court, the Referee's order was sustained by order dated December 9th, 1947.

The notice of appeal from the order of Judge Coxe was filed on January 7th, 1948.

The attorney for the Trustee is David Haar and the attorney for the Comptroller of the City of New York is John P. McGrath, Esq., who became attorney for the Comptroller following the resignation of Charles E. Murphy, former attorney for the City of New York.

There is no change of parties or attorneys, except as indicated.

No one was arrested and no property was attached in this proceeding.

[fol. 2] IN UNITED STATES DISTRICT COURT

ORIGINAL PROOF OF CLAIM

The claim of the City of New York as originally filed, is, in substance, as follows:

Nature of Tax	Year of Taxable Period	Total
SALES TAX (M-263454) Ch. 41 Titles E and N Administrative Code	10/21/34 to 1/5/44	750.00
Total due for Sales Tax (Sec. 7)		750.00
BUSINESS TAX Ch. 41 Titles E, O R & RR Administrative Code, L. L. 9 of 1934	1933 to 1943	250.00
Total due for Business Tax (Sec. 8)		250.00
	TOTAL	$1000.00

Together with additional interest at ½% per month until paid.

The claim was verified May 17, 1944, by Saul Berlin of the Bankruptcy Assignment Unit, on behalf of George Marlin, Special Deputy Comptroller of the City of New York.

[fol. 3] IN UNITED STATES DISTRICT COURT

AMENDED PROOF OF CLAIM

The City of New York, Office of the Comptroller, Bureau of Excise Taxes, 74 Trinity Place, New York 6, N. Y.

Reg. No. M-283454, Claim No. 14507, Docket No. 83203

File with: Hon. John E. Joyce, Referee, U. S. Court House, Foley Square, New York, N. Y.

In the Matter of SPOTLIGHT PRODUCTIONS, INC., 119 West 57th Street, New York, N. Y., Debtor

STATE OF NEW YORK,
County of New York, ss:

Louis A. Sachs, of the County of New York, State of New York, being duly sworn, deposes and says:

1. That he is the head of the Bankruptcy and Assignment Unit of the Bureau of Excise Taxes in the Office of the Comptroller of the City of New York, a municipal corporation of The State of New York, and is duly authorized to make this proof of claim on its behalf.

[fol. 4] 2. That Spotlight Productions, Inc., the above named bankrupt, was at and before the filing by or against him of the petition for adjudication of bankruptcy, and still is, justly and truly indebted or liable to said corporation in the sum of $870.43.

3. That the consideration of said debt or liability is as follows:

A schedule is attached hereto and made part hereof as if set forth in full.

4. That no part of said debt or liability has been paid, except

5. That there are no set-offs or counterclaims to said debt or liability, except

6. That said corporation does not hold, and has not, nor has any person by its order, or to deponent's knowledge or belief, for its use, had or received, any security or securities for said debt or liability except

7. That no note or other negotiable instrument has been received for such account or liability or any part thereof; and that no judgment has been rendered thereon, except

8. That demand is hereby made that the aforesaid claim be allowed and paid in full as a priority claim in advance of any distribution to creditors; and furthermore, that the said claim be entitled to the rights of a lien claimant pursuant to the provisions of the Administrative Code of The City of New York and the Bankruptcy Act.

9. That the said corporation, by its duly constituted authorities, has duly made the assessment set forth herein [fol. 5] by way of proof of claim pursuant to the provisions of the Administrative Code of the City of New York enacted for the collection of the taxes set forth therein.

Louis A. Sachs, Head of Bankruptcy and Assignment Unit of the Bureau of Excise Taxes in the Office of the Comptroller of The City of New York.

(Verified.)

SCHEDULE, ANNEXED TO AMENDED PROOF OF CLAIM

Reg. No. M283454

In the Matter of SPOTLIGHT PRODUCTIONS, INC.

Schedule of Taxes due by bankrupt at and before the filing of the petition based on audit. The City of New York by its duly constituted authorities, has duly determined the amount of taxes as more fully described below.

SALES TAX Pursuant to Ch. 41 Title "E" and "N" Administrative Code of the City of New York.	Principal of Tax	Interest to date of proof of claim	Monthly rate of interest
Taxable Period			
11/1/40 - 6/30/41			1%
7/1/41 - 5/30/42	$495.61	$341.97	1%
Total Sales Tax	$495.61	$341.97	$837.58

[fol. 6]

BUSINESS TAX

Pursuant to Ch. 41 Titles "E", "O", "R" & "RR" Administrative Code of The City of New York	Principal of Tax	Interest to date of proof of claim	Monthly rate of interest
For the privilege of doing business during the period			
11/1/40 – 6/30/41	10.88	7.83	1%
7/1/41 – 5/30/42	8.84	5.30	1%
Total Business Tax	$19.72	$13.13	$32.85

Together with additional interest for the period from the date of this proof of claim to the payment thereof, on the principal amounts stated above, at the rates permitted by law.

[fol. 7] IN UNITED STATES DISTRICT COURT

NOTICE OF MOTION OBJECTING TO CLAIM OF CITY OF NEW YORK

SIR:

Please take notice that on the annexed petition of David Haar, attorney for the trustee, a motion will be made before Hon. John E. Joyce, Referee in charge of these proceedings, at his office Room 237 in the United States Court House, Foley Square, in the Borough of Manhattan, City of New York, on the 1st day of July, 1947, at 10:30 o'clock in the forenoon, for an order expunging the claim of the City of New York in the sum of $1000.00 filed in or about May, 1944, and for such other relief as in the premises may seem proper.

Dated, New York, June 24th, 1947.

Yours, &c., David Haar, Attorney for Trustee, 270 Broadway, New York City.

To: Hon. Lazarus Joseph, Comptroller of City of New York, Municipal Building, New York City.

[fol. 8] IN UNITED STATES DISTRICT COURT

PETITION

To the Honorable John E. Joyce, Referee:

The petition of David Haar respectfully shows:

1. Your petitioner is the attorney for Lewis H. Saper, the trustee herein, and on his behalf objects to the allowance of the claim of George Marlin, Special Deputy Comptroller of the City of New York, for the sum of $1000.00, filed herein in or about May, 1944.

2. The claim on the face of its shows that it is not allowable as a claim. The sales taxes are claimed from December 10th, 1934 to January 5th, 1944, in the sum of $750.00. There is no statement annexed showing what sales were had by the bankrupt corporation on the basis of which a tax is claimed. Moreover, there couldn't have been any sales prior to December 1940, which was the date of the incorporation of the bankrupt.

3. In addition there has been a business tax imposed for $250.00 for the period of 1933 to 1943.

4. The same reason for objecting to this claim is advanced as was presented to the sales tax.

Wherefore, your petitioner respectfully prays on behalf of the trustee that the claim be rejected and expunged.

Dated, New York, June 24th, 1947.

David Haar, Petitioner.

(Verified.)

[fol. 9] In United States District Court

Minutes of Hearing

In re: Spotlight Productions, Inc., Bankrupt

Before—Hon. John E. Joyce, Referee

Adjourned Hearing on Motion re Claim of The City of New York.

New York, July 17, 1947, at 2 P. M.

Appearances

David Haar, Esq., Attorney for Lewis H. Saper, Esq., Trustee.

Jay Cohen, Esq., Assistant Corporation Counsel, Representing Claimant.

Colloquy

The Referee: Spotlight Productions.

Mr. Haar: The Trustee is ready, except that I have not had an answer yet from the respondent.

The Referee: What is the application?

Mr. Haar: To expunge the claim.

They came around and examined our books and records; and I would like to get an answer, just to see—there has been no issue joined. Therefore I will ask that the motion be granted. There is no answer by the City.

Mr. Cohen: What happened here was, we audited whatever records were available and the City prepared an amended claim; but due to stenographic troubles it has not been filed yet. I think by Monday it will be filed.

The Referee: Have you the figures here?

Mr. Cohen: Yes; I will give him the figures.

(Discussion off the record.)

Mr. Haar: I would still like to know how these figures are arrived at. I think I am entitled to, under the statute.

The Referee: We can determine that.

[fol. 10] Mr. Haar: Is that going to be your answer: that that is going to be the amount of the tax?

Mr. Cohen: We are filing an amended claim and the basis of the tax.

The Referee: The 29th at 2 o'clock.

The objections will stand as to the amended claim. File it by Tuesday.

Adjourned to Tuesday, July 29, 1947, at 2 P. M.

Adjourned Hearing on Motion re Claim of The City of New York.

New York, July 29, 1947, at 2 P. M.

Present:

David Haar, Esq., Attorney for Lewis H. Saper, Esq., Trustee.

Jay Cohen, Esq., Assistant Corporation Counsel, Representing Claimant.

The Referee: Spotlight Productions.

Mr. Haar: The Trustee is ready so far as he can be.

I think your Honor ought to know what the situation is.

Since the last time we were here the City filed what they called an amended return. The amended return is no more informative than the original one. It has been reduced to $495.61, with interest amounting to almost as much, $341; and

Another item of $10.

Now, I cannot tell whether or not that tax is correct or incorrect unless there is a statement filed, as the Bankruptcy Act requires, and the General Orders require, showing how that debt is made up.

[fol. 11] The same thing applies to the other one.

The Referee: Is the City ready?

Mr. Cohen: The City is ready.

The Referee: Are you ready to prove the assessment?

Mr. Cohen: Yes, sir.

The Referee: All right; proceed. If the assessment is proved, it will be a prima facie claim.

Call a witness.

Mr. Cohen: Your Honor, we do not have to go forward with any proof.

The Referee: Yes, you do. You have to show an assessment by the Comptroller.

Mr. Cohen: Well, we have. We have filed an amended proof of claim here.

The Referee: That is not sufficient.

(Discussion off the record.)

Mr. Cohen: Your Honor, we stand on our claim.

We are relying on the following cases of law:

In re Glotzer, et al.
Garfield Bag & Stationery Co.

The Referee: Where are the cases reported?

Mr. Cohen: We took them out of the Bankruptcy Reports. I will call you back later today.

The Referee: You have not got them here now?

Mr. Cohen: Not those two.

The others I have:

Whitney v. *Dresser*, 200 U. S. 532.
In re General Film Corp., 274 Fed. 903.
In re Hannevig, 10 Fed. 2nd 941.
And *In re Bradley*, 16 Fed. 2nd 301.
In re Lang Body Co., 92 Fed. 2nd 338, cert. denied

(I don't have the page reference to the cert. denied).

Hipp v. *Boyle*, 303 U. S. 637; and
In re Raflowitz, 37 Fed. 2nd 202.

[fol. 12] And we rely upon these cases to the extent that a verified proof of claim is prima facie in its validity, when filed.

The Referee: Have you got it with respect to a claim of distraint of the City of New York?

I have written an opinion holding that this form of claim is not sufficient.

If you will tell me where those cases are reported I will look at them. Otherwise I will adjourn this matter.

Mr. Cohen: Do you have a library?

The Referee: No. I will adjourn the matter.

Will you submit just the names of the cases and where they can be found, tomorrow or the next day.

August 12th, at 11:30.

Adjourned to Tuesday, August 12, 1947, at 11:30 A. M.

Adjourned Hearing on Motion re Claim of The City of New York.

New York, August 12, 1947, at 11:30 A. M.

Present:

David Haar, Esq., Attorney for Lewis H. Saper, Esq., Trustee.

Jay Cohen, Esq., Assistant Corporation Counsel, Representing Claimant.

The Referee: Spotlight Productions.

Mr. Cohen: Your Honor, since our last meeting Mr. Haar wrote a letter in which he stressed the fact that his objection is one to the form of the claim rather than to the claim itself. [fol. 13] If that be so, then it escaped me entirely, that that was his position.

Now, on that I would like to say something, if you don't mind, namely, the claim itself—we used the same form of claim which we have for years, and Referee Stephenson had indicated several times that he thought we ought to change the form; and a conference was arranged with him and a representative of our office——

The Referee: I think I wrote an opinion on that, February, 1944.

This form seems to have been revised in June, 1944.

Mr. Haar: I have set that forth in my objection and the argument that I made; and I believe your Honor indicated that I was more or less right.

I want to know how this very tax was made up.

The Referee: I hold that the claim is prima facie and that the burden is on the Trustee to go forward with evidence; and in support of that ruling I cite the cases: *In re Bradley*, 16 Fed. 2d 301; *In re Glotzer*, 42 Fed. Supp. 712; and *In re Garfield Bag & Stationery Co.*, 42 F. Supp. 708.

Mr. Haar: Well, your Home knows how handicapped I am——

The Referee: I do not think you are handicapped so much, Mr. Haar; because while the record may not show it, I proceeded, in the nature of a pretrial, and the City had its accountant here and he produced his figures showing how he made up the items that are the basis of the proof of claim, by the Comptroller; so that you really have something.

Mr. Cohen: I would like to add, if I may, your Honor, that I invited Mr. Haar at least ten times to come over and discuss the claim, and he never did so.

Mr. Haar: All right. Will the accountant take the stand.

[fol. 14] JOSEPH SCHLISSEL (residing at No. 108 Ross Street, Brooklyn, N. Y.) called as a witness by the Trustee, being first duly sworn by the Referee, testified as follows:

Direct examination.

By Mr. Haar:

Q. Mr. Schlissel, are you an accountant employed by the City of New York in connection with the preparation of its tax claims in bankruptcy cases?

A. I am.

Q. Are you a certified accountant?

A. No.

Q. You have had experience in auditing books, I dare say, is that it?

A. Yes.

Q. Did you have anything to do with the preparation of the figures which have been used in this amended proof of claim filed in this case?

A. Yes.

Q. What did you do?

A. I examined all the records that were made available and derived these figures from those records.

Q. What do you mean when you say you examined "all the records that were made available?" Were there any kept from you?

A. That I cannot say.

Q. What books did you examine?

A. Evidently there was a record kept——

Q. (Interposing): I am asking you what books did you examine?

A. A cash book; general journal.

Q. Anything else?

A. And in connection with that, I looked at an accountant's report.

Q. I am asking you the books of the bankrupt which you examined.

A. A cash book and a general journal.

Q. I show you a book and ask you if this is one of the books which you examined (handing).

A. Yes, sir.

Mr. Haar: I offer it in evidence.

(No objection.)

(Marked Trustee's Exhibit 1, 8/12/47.)

[fol. 15] By the Referee:

Q. What book is that?

A. That is a cash book.

By Mr. Haar:

Q. And is this another book which you examined (handing)?

A. Yes, sir.

Q. What book do you call that?

A. That is a general journal.

Mr. Haar: Please mark that in evidence.

(No objection.)

(Marked Trustee's Exhibit 2, 8/12/47.)

Q. Was it from these two books that you gathered your figures and on the basis of which you found the figure of $495.61 as the principal of the tax as indicated in the amended proof of claim?

A. That is right, yes.

Q. Will you please give me the figures which you used in order to make that determination?

A. Those figures are broken down into two periods, 11/1/40 through 7/31/41.

Q. All right.

A. There are two items in that period that were deemed taxable: Purchases of machinery and equipment amounting to $849.91; and

Sales of machinery, amounting to $12,240.97.

Making a total of $13,090.88, which is all taxable at 2%.

And the second period, 8/1/41——

(Q. (Interposing): Let's first take that first period for a minute, if you don't mind, Mr. Schlissel.

You say there was a purchase of machinery in that period?

A. That is right.

Q. Amounting to $849.91?

A. That is right; purchase of machinery for own use.

[fol. 16] Q. What is there in the books to show that the purchase was made in that year rather than a previous year and payment made in that year?

A. The period of nine months to——

Q. (Interposing): Did you understand my question, Mr. Schlissel?

A. Yes.

Q. All right; will you please answer it?

A. Well, to answer that, the figures are on the books and there are no purchase invoices made available and we assume that those purchases were made during that period.

Q. In other words, you do not know, but you are only assuming; is that your answer?

A. Well——

Q. (Interposing): Is that your answer?

A. No, that is not my answer.

The business started from 11/1/40—from all indications of the records, the business started 11/1/40, or around there; and we assumed that the purchases were made from that date on.

Q. Again I say that you do not know but you are assuming the fact on the basis of which you are giving your testimony?

A. Well, we assume everything that we see on the books.

Q. Now you say there was a sale of machinery. Do you mean to say that this machinery that was purchased for $849 was sold during that period for $12,000?

A. No, sir, it was not. The purchase of machinery and equipment is not the same machinery and equipment that is sold. That is machinery and equipment bought for their own use, of manufacturing or processing or things like that.

The sales of machinery was machinery that was manufactured for sale.

Q. Oh, you mean the machines in which the company was engaged in the business of manufacturing?

A. That is right.

[fol. 17] Q. I see.

A. Like furniture and fixtures would be taxable.

Q. I understand; all right; and you say that that amounts to $12,000, from the books as you saw it?

A. That is right.

Q. Then the total is $13,000.

2%, that is 261; is that about right, approximately?

A. It is about right. I have the two figures combined.

Q. All right; what else?

A. That is all in that period.

The second period was from 8/1/41 through 5/30/42.

Q. What did you find there?

A. The purchase of machinery and equipment, $565.

Q. Yes?

A. Rental of equipment, $1,091.50.

Q. What do you mean by that? That they rented other people's equipment?

A. That is right.

Q. For which they paid what?

A. For which they paid some weekly—it must have been some weekly or bi-weekly rental payment. About $50 every two weeks rental of machinery.

Q. How much was that?

A. $1091.50 and that is taxable.

Q. Yes?

A. And sales of machinery, $16,327.91.

Making a total of $17,984.41.

And that covers a period of ten months, of which approximately seven months, seven-tenths of that is taxable at 1%, and the other three-tenths at 2%.

Q. Have you calculated that?

A. Yes; because the months of August, September and October was still in the 2% period; and the local law, from 10/27/41 to 7/1/46, the tax has been reduced to 1%.

Q. Will you show me where in either of the books there is a record of the sale of $16,327.91?

A. Oh, here is what I wanted to show you.

The journal entry made in December, 1941, there is a credit to sales of $20,661.50; but I gave the taxpayer the benefit of the doubt, because during that period, in con- [fol. 18] junction with the examination of the accountant's report, it showed the lesser figure. So I took the lesser figure.

Q. Then the figure of $16,000 is not one that is found on the books of this bankrupt, is it?

A. No; but if I were to take the books of the bankrupt, it would be $20,000.

Q. Please answer my question. That is not on the books of the bankrupt, is it?

A. Not on the books directly, no, sir.

Q. You were using something outside of the books of the bankrupt, together with the books of the bankrupt, and you came to the conclusion that $16,000 represented the sales for that period; is that your answer?

A. That is right.

Q. And that is what you did?

A. That is right.

Q. Now, did you find in these books any records of returns of machinery?

A. No, sir.

Q. All right; now, what about the item of rental of $1091.50? Will you show me where that is found on the books of the bankrupt?

A. From the beginnning of the books—from August, 1941 on, it has been shown that there evidently was a ledger account called "Rental of Equipment."

Q. What do you mean by "evidently"? You mean it is not there, but you are assuming it to be so?

A. There is an account here called "Rental of Equipment," and it was evidently a general ledger account, folio 73.

By the Referee:

Q. Are there any figures in that book opposite the label you have just given of "Rental of Equipment"?

A. Yes, sir; "Rental of Equipment"; that is the heading of the column.

By Mr. Haar:

Q. What are those figures? Do they make up $1091.50?

A. These figures make up $1091.50. It goes right through.

Q. Let em see it.

[fol. 19] (Witness indicates to counsel.)

Q. The very first item of $60 is brought forward on that line from something else, is it not—from some prior date, is it not (indicating)?

A. Well, the money was paid out August 20th, $60. Evidently no tax.

The $60 is brought forward from a previous page (indicating).

Q. What you are showing me is a succeeding, subsequent page, not a preceding page?

A. Well, preceding page—the item of $60 is on page 56.

Q. All right; you say that is brought forward from page 56?

A. That is how the books are written up. That makes no difference.

Q. That makes no difference to you?

A. No difference whatsoever; because this cash book, the bookkeeper, or whoever wrote in here, started from the back here, November, 1940, on page 75; December on page 74—he evidently started the cash receipts from the beginning of the book and worked backwards, for cash payments—they call it brought forward.

Q. Then you went backward from August, 1941 on this page?

A. I went backward in the pages, but forward in the dates.

Q. I understand that; that is what I want to make clear. Now, under what Section of the Administrative Code is there a tax imposed on expenditures by a firm or a taxpayer?

A. Well, I cannot answer that question. I don't know the exact Section.

Q. You have been working on this thing. Why did you include an expenditure as a basis for imposing a tax?

A. That expenditure is taxable; there is no doubt about it; because it was an expenditure for the purchase—or rental of equipment.

That is a legal question.

[fol. 20] Mr. Cohen: I object to the question.

The Referee: Sustained.

Mr. Haar: Well, you tell me.

Mr. Cohen: The Sales Tax Law imposes a tax not only on sales, but also on items bought—that is, on purchases by a taxpayer, which he consumed himself in the process of manufacturing, on which no tax had been paid by him.

That is two.

And three, on the rental of items, as for example, rental of machinery and equipment, rental of automobiles, rental of vending machines and things of that sort.

Mr. Haar: In what Section of the Code will I find that?

Mr. Cohen: That is a ruling by the Comptroller.

Mr. Haar: Under what Section of the Code is that ruling made?

Mr. Cohen: A ruling made under the General Provisions of the Sales Tax——

Mr. Haar (Interposing:) What is the Section of the Code under which that tax is imposed and the ruling made?

Mr. Cohen: The Section is R-41 of the Administrative Code—or rather, N-41 of the Administrative Code. Chapter 41.

(Discussion, off the record.)

By Mr. Haar:

Q. You have concluded giving me the figures for the upper portion of this amended tax, have you?

A. The sales tax part.

Q. Yes. How did you arrive at the figures—or what figure did you use which makes up the $10.88 and the $8.84 business tax?

[fol. 21] Mr. Cohen: Are you all through with the sales tax now?

Mr. Haar: I gues- so. I am going on to something else.

The Witness: I would like to say something.

The Referee: Yes?

The Witness: In connection with the sales tax, it is the practice of the Department to estimate sales made during unexplained periods.

In this particular case the records go up to 5/30/42; and the petition in bankruptcy, or whatever it is called, was signed in January, 1944.

There is a period there of about nineteen months; and I was told by the Department to estimate sales based upon the previous sales. However, we did not do that, because the examination of various records, such as records in the Referee's office, the bank account had been closed out, records in the District Attorney's office and information received from the accountants of the firm—all those sources did not reveal any additional sales; and therefore, since we had no basis, we did not estimate that period.

By the Referee:

Q. Well, the claim only runs to May 30th, or June 30th, 1942?

A. That is right.

Q. And that period is covered by these two books, is that right?

A. That is right.

The Referee: And the other is immaterial.

By Mr. Haar:

Q. Will you answer the question I put to you regarding that little business tax that you impose? How did you arrive at that?

A. The business tax estimate is made for all sales re- [fol. 22] corded before—that is, the $28,568.88, broken down into the various local laws, for 1940 and 1941.

Q. How did you arrive at the interest of $341.97?

A. That is an average rate. We charge interest at the rate of 1% a month from the date that the return is due until the date of the claim; and for all those periods it is an average of 6%.

Mr. Haar: Will you tell me under what Section, Mr. Cohen, interest is calculated in that amount? Do you happen to know it?

Mr. Cohen: I do not have it in front of me but I will give it to you.

Mr. Haar: Yes; I would like to know about that.

That is all I have, your Honor, for this witness.

The Referee: Cross-examine.

Cross-examination.

By Mr. Cohen:

Q. Were there any sales tax returns filed for the period involved in this proceeding, namely, 11/1/40 to May 30, 1942?

A. There are no returns filed for that period.

Q. Were there any business tax returns filed for the years 1940 or 1941?

A. No business tax returns filed for those years.

Q. In examining the cash book did you find reference to a ledger by posting page totals at the end of the various columns?

A. I did.

Q. And was a general ledger made available to you?

A. No, sir.

Q. Did you ask for a general ledger?

A. Yes, sir.

Q. And what was said?

A. I don't know the exact words of Mr. Haar, but he said he didn't have it.

Mr. Haar: Those are the exact words he said; because that is the fact.

[fol. 23] Mr. Cohen: That is all.

The Referee: All right. Is there any further proof?

Mr. Haar: No; I cannot, your Honor—that is all I can do.—

The Referee: I am only interested in whether you have any further proof.

Mr. Haar: None.

The Referee: Do both sides rest?

Mr. Cohen: Yes, sir.

Mr. Haar: I do.

(Closing arguments by counsel.)

(Briefs to be submitted in two weeks.)

[fol. 24] IN UNITED STATES DISTRICT COURT

REPORT OF REFEREE

The issues raised by the trustee's objections to the claim of the City of New York for sales and business taxes, superseded by an amended claim for $495.61 sales tax plus interest and $19.72 business tax plus interest, to which the objections are made applicable but were withdrawn as to the business tax principal, having been tried, I find and decide as follows:

1. The bankrupt during the period from November 1, 1940 to July 31, 1941 purchased machinery and equipment in the amount of $849.91 and sold machinery in the amount of $12,240.97, a total of $13,090.88.

2. During that period the sales tax rate was 2%.

3. Between August 1, 1941 and May 31, 1942 the bankrupt purchased machinery in the amount of $565, rented equipment at a cost of $1,091.50, and made sales to the extent of $16,327.91, a total of $17,984.41.

4. The tax rate for seven-tenths of the latter period was 1% and for the remainder was 2%.

5. No sales tax return or business tax return was filed for either period.

Conclusions

1. The bankrupt was liable for the tax imposed on sales by it of tangible personal property.

2. The bankrupt as a purchaser of tangible personal property was directly liable for the tax imposed.

[fol. 25] 3. The bankrupt was liable for a tax on the amount of rental paid or agreed to be paid to the lessor or licensor for the possession of tangible personal property.

4. The City is entitled to interest at the rate of 1% per month on the sales tax amounting to $495.61.

5. The City is entitled to interest at the rate of 1% per month on the business tax amounting to $19.72.

6. The City is entitled to interest on the principal sums of such taxes to the date of payment.

Opinion

The second conclusion is supported by *McGoldrick* v. *Berwind White Coal Mining Company*, 309 U. S. 33; *Kesbec* v. *McGoldrick*, 278 N. Y. 293, 297; *Merchants Refrigerating Co.* v. *Taylor*, 275 N. Y. 113, 124. Concerning the third, a transfer of possession for a consideration is defined as a sale by the Administrative Code of the City of New York, Sec. N 41-1.0. That definition is valid: *United Artists Corporation* v. *Taylor*, 273 N. Y. 334, 341.

The trustee's assertion that more than simple interest is a penalty finds some support in the Administrative Code which provides "Penalties and Interest" in Sec. N 41-17.0 on sales taxes and in Sec. O 41-14-0 on business taxes. The former provides a penalty of 5% and the latter 10% on the amount of the tax. In both that penalty is followed by

> plus interest at the rate of one per centum of such tax for each month of delay excepting the first month after such return was required to be filed or such tax became

due; but the controller or as provided in section N 41-13.0 the treasurer *if satisfied that the delay was excusable may remit all or any part of such penalty,* [fol. 26] *but not interest at the rate of six per cent per year* (emphasis added).

It is fairly inferable from the above language that the imposition of a charge of more than 6% per annum is punishment for a wilful or inexcusable failure to file a return and pay the tax timely and as such it has the elements of a penalty, but authorities hold otherwise and must be allowed here. *In re Gandolfi & Co. Inc.*, 42 F. Supp. 706; *In re Flayton*, 42 F. Supp. 1002; *Cf. In re Sermon*, 80 F. (2d) 81; *In re Beardsley* v. *Wolcott Mfg. Co.*, 82 F. (2d) 239.

The authorities, with an exception made recently, *In re Union Fabrics*, unreported, see N. Y. Law Journal, August 2[illegible] 1947, hold that tax claims carry interest to the date of payment. *Dave* v. *Green* 133 F. (2d) 451; *In re Gandolfi & Co. Inc., supra; In re Flayton, supra.* The case of *Vaston Committee* v. *Green*, 329 U. S. 156, did not deal with a tax claim but with compound interest to a secured creditor. Objections overruled. Settle order on notice.

September 10, 1947.

John E. Joyce, Referee in Bankruptcy.

[fol. 27] IN UNITED STATES DISTRICT COURT

ORDER OF REFEREE

The City of New York, having filed with the Referee on May 19, 1944 a proof of claim alleging that the bankrupt is justly and truly indebted to the City of New York for sales taxes with interest as provided for by statute to the date of payment of said claim, which taxes accrued over the period beginning December 10, 1934 and ending January 5, 1944, in the amount of $750, with interest to accrue thereafter, and for New York City business taxes, which accrued during the period 1933-1943 in the amount of $250, with interest to accrue thereafter; and the trustee, by notice of motion, dated June 24, 1947, and petition verified June 24, 1947, having moved for an order to reject and expunge said proof of claim of the City of New York; and the City of New

York having superseded its proof of claim by filing with the Referee herein on July 18, 1947 an amended proof of claim alleging that the bankrupt is justly and truly indebted to the City of New York for New York City sales taxes, which accrued over the period beginning November 1, 1940 to May 30, 1942, in the principal sum of $495.61, with interest which had accrued thereon to July 18, 1947 in the sum of $341.97, and additional interest at the rate of one per cent per month on the principal until the date of payment of said claim pursuant to Chapter 41, Titles "E" and "N" of the Administrative Code of the City of New York, and for New York City business taxes, which accrued during the period from November 1, 1940 to May 30, 1942, in the principal amount of $19.72, with interest thereon to July 18, 1947, in the sum of $13.13, and additional interest at the rate of one per cent per month on said principal amount until the date of payment thereon, pursuant to Chapter 41, Titles [fol. 28] "R" and "RR" of the Administrative Code of the City of New York; and the trustee's notice of motion, dated June 24, 1947, petition and objections verified June 24, 1947, having been duly made applicable to the aforesaid amended claim of the City of New York except as to the trustee's objection to the claim of the City of New York as to the principal amount of said claim for business taxes in the sum of $19.72 which objections were withdrawn, but not as to the claim for interest thereon; and after taking testimony upon said petition and objections and in opposition thereto on August 13, 1947; and after hearing David Haar, Esq., attorney for the trustee, in support of said motion, and Charles E. Murphy, Esq., Corporation Counsel of the City of New York, in opposition thereto; and due deliberation having been had, and the opinion of the Referee having been filed,

Now, it is hereby:

Ordered, that the motion to expunge the amended claim of the City of New York for New York City sales and business taxes be and the same is hereby denied and that the petition therefor be and the same hereby is dismissed; and it is further

Ordered, that the amended claim of the City of New York for New York City sales taxes herein be and the same hereby is allowed as a claim entitled to priority under Section 64a(4) of the Bankruptcy Act, as amended by the Chandler

Act, in the sum of $495.61, with interest to July 18, 1947 in the sum of $341.97, and with interest thereafter at the rate of one per cent per month on the principal sum of $495.61 from July 18, 1947 to the date of payment of said claim, pursuant to Chapter 41, Title "N" of the Administrative Code of the City of New York; and it is further

[fol. 29] Ordered, that the amended claim of the City of New York for business taxes herein be and the same hereby is allowed as a claim entitled to priority under Section 64a (4) of the Bankruptcy Act, as amended by the Chandler Act, in the principal sum of $19.72, with interest thereon to July 18, 1947 in the sum of $13.13, and with interest thereafter at the monthly rate of one per cent on the said principal amount of $19.72 up to the date of payment of the said claim, pursuant to Chapter 41, Titles "R" and "RR" of the Administrative Code of the City of New York.

Dated: September 23, 1947.

John E. Joyce, Referee in Bankruptcy.

IN UNITED STATES DISTRICT COURT

PETITION TO REVIEW ORDER OF REFEREE

To the Honorable John E. Joyce, Referee:

The petition of Lewis H. Saper respectfully shows:

1. Your petitioner is the trustee of the estate of the bankrupt above named.

2. Your petitioner, feeling aggrieved by the order heretofore made in this proceeding and dated the 23rd day of September, 1947, respectfully files this petition to review said order pursuant to the Bankruptcy Act and the Rules of this Court pertaining thereto.

[fol. 30] 3. The order which your petitioner seeks to review, was the result of a proceeding brought on his behalf as trustee for an order to expunge the claim of the City of New York for sales tax and interest, as well as a business tax and interest claimed to be due to said claimant. Upon the hearing of the application, the City of New York filed an amended proof of claim, subject to the same objections to its allowance filed by your petitioner as trustee.

4. Thereafter, a hearing having been held with respect to the amount of the claim and interest due thereon, such proceedings were had that this Court made an order allowing the amended claim of the City of New York for sales tax, as a claim entitled to priority in the sum of $495.61, with interest to July 18th, 1947 in the sum of $341.97, and with interest thereafter at the rate of 1% a month on the principal sum of $495.61, from July 18th, 1947, to the date of payment of said claim.

5. The order also provided that the amended claim filed by the City of New York for business taxes be allowed as a priority in the principal sum of $19.72, with interest to July 18th, 1947, in the sum of $13.13, and with interest thereon at the rate of 1% per month on the principal sum of $19.72 up to the date of payment of said claim.

6. Your petitioner feels aggrieved by the making of said order and believes it to be erroneous in the following respects:

The order is made upon a finding that the bankrupt purchased machinery and equipment for the period from November 1, 1940 to July 31, 1941, in the sum of $849.91, and that thereupon, as a conclusion of law, the bankrupt, as a purchaser of tangible personal property, was directly liable for the tax imposed. The error complained of with respect [fol. 31] to this particular finding and conclusion, is that there is no proof that the person or persons, or corporations from whom, or from which, the bankrupt purchased the machinery and equipment in the total sum of $841.91, did not collect the tax required under the Administrative Code in the said sum of $841.91 and turned said tax over to the City of New York.

7. The conclusion of law, as your petitioner has been advised by counsel with respect to this particular item, is erroneous as a matter of law.

8. A similar error of law is presented in this petition to review with respect to finding number 3 on purchases between August 1, 1941, and May 31st, 1942, in the sum of $565.00, and for the rental equipment in the sum of $1,091.50, on which the conclusion of law by the learned Referee is to the effect that the bankrupt was liable for a tax on the

amount of said rental paid, or agreed to be paid to the lessor or licensor for the possession of tangible personal property.

9. Your petitioner is also aggrieved by the order insofar as it is based on a finding that the claimant is entitled to interest both on sales made by it and purchases made by it in the total sum of $495.61, and also that the claimant, the City of New York, is entitled to interest in the sum of $19.72 on business tax.

10. Error is also predicated on the finding of law that the claimant is entitled to interest on the principal sums of such taxes up to the date of payment.

Wherefore, your petitioner respectfully prays that the learned Referee file a certificate in review pursuant to law and the rules of this Court, so that the order made [fol. 32] herein on September 23d, 1947, may be reviewed by the District Court, and such proceedings taken thereon as may be just and proper.

Dated, New York, October 1st, 1947.

Lewis H. Saper, Petitioner.

(Verified.)

IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

In the Matter of

SPOTLIGHT PRODUCTIONS, INC., Bankrupt

CERTIFICATE ON PETITION FOR REVIEW

To the Honorable, the Judges of the United States District Court for the Southern District of New York:

I, John E. Joyce, Referee in Bankruptcy, do hereby certify the following:

1. Petition of Lewis H. Saper, trustee in bankruptcy, to review an order denying the petition of David Haar, his attorney, to expunge a claim filed by the City of New York;

2. Order, dated September 23, 1947, to be reviewed;

[fol. 33] 3. Petition of David Haar, attorney for trustee in bankruptcy, with notice of motion and proof of service;

4. Amended proof of claim of the City of New York;

5. Transcript of the evidence;

6. Copy of the findings and conclusions with opinion.

A statement of the facts, and the question involved appears in findings and opinion. The errors assigned are as stated in the petition for review.

October 23, 1947.

Respectfully submitted, John E. Joyce, Referee.

To be placed on the Bankruptcy Motion Calendar, Room 506, United States Court House, New York, N. Y. for hearing on October 29, 1947, and notice given by mail to:

David Haar, Esq., 270 Broadway, New York 7, N.Y.
Charles E. Murphy, Esq., Corporation Counsel, Municipal Building, New York 7, N. Y.

[fol. 34] In United States District Court

Appearances:

Charles E. Murphy, Esq., Corporation Counsel, Attorney for the City of New York. Francis I. Howley and Leroy Mandle, Esq., of Counsel.

David Haar, Esq., Attorney for Trustee.

Memorandum

Coxe, *D. J.*:

The Referee was right in holding that the bankrupt estate is liable to the City of New York for sales taxes on purchases of machinery and equipment by the bankrupt. The sales tax is imposed upon the purchaser (Section SN41-2.oe, Administrative Code, New York City), and if the purchaser fails to pay the tax to the vendor, it must be paid by the purchaser to the City Treasurer (Section SN41-2, of, Administrative Code, New York City). "The ultimate burden of the tax * * * is thus laid upon the buyer, for consumption, of tangible personal property, and measured by the sales price." *McGoldrick* v. *Berwind-White Co.*, 309 U. S.

33, 43. The purchases here were made within the City and were not for purposes of resale, and there is no evidence that the bankrupt paid any sales taxes thereon. The fact that the City may also collect from the vendor does not relieve the purchaser of his obligation to pay the tax. *Fifth Ave. Bldg. Co.* v. *Joseph*, 272, App. Div. 449. Aside from this, however, the trustee failed to offer any proof that the vendors had paid the sales taxes on the machinery and equipment purchased by the bankrupt, and it may therefore be assumed that such taxes have not been so paid.

[fol. 35] The Referee was also right in his conclusion that the City is entitled to interest on its tax claim to the date of payments. This is in accord with the general rule. *In re J. Menist & Co.*, 290 F. 947, modified on other grounds sub nom. *United States* v. *Childs*, 26 U. S. 304; 3 Collier on Bankruptcy (14th Ed.) Sec. 63.16. The argument that interest should stop with the filing of the bankruptcy petition because of the 1938 changes in Section 57n (11 U. S. C. A., Sec. 93n), and Section 64 (11 U. S. C. A., Sec. 104) does not seem to be valid, and it has been rejected by one federal appellate court. *David* v. *Green*, 133 F. (2d) 451. Sec. 57n as amended simply substitutes a statutory bar to the filing of governmental claims for a court made bar. It is designed, so far as relevant and tempered by the provision for extension, to subject such claims to the same requirements as to filing as other claims and to speed up closing of estates. Senate Report No. 1916 on H. R. 8046, 75th Cong. 3d Sess. (1938). Old Section 64b (11 U. S. C. A., Sec. 104b) provided that priority debts, which included taxes, should be "paid in full" before payment of dividends to creditors, and Section 64a as amended (11 U. S. C. A., Sec. 104a) contains the same provision. Further, Section 57j (11 U. S. C. A., Sec. 93j) has not been changed in substance and still requires the allowance of governmental debts with accrued interest thereon. There is no clear evidence of any congressional intent to depart from the general rule so long accepted. Finally, there is nothing in the record here to charge the city with the delay in payment of its claim and thus justify the Court in denying interest on equitable grounds. Cf. *In re South Coast Co.*, 22 F. Supp. 652.

The order of the Referee is affirmed.

Alfred C. Coxe, U. S. D. J.

December 1, 1947.

[fol. 36] In United States District Court, Southern District of New York

Order Dismissing Petition to Review and Affirming Referee's Order Appealed From—December 9, 1947

Lewis H. Saper, Trustee herein, having filed a petition to review the order of Hon. John E. Joyce, Referee in Bankruptcy, dated September 23, 1947, allowing the amended claim of the City of New York for sales taxes in the sum of $495.61 with interest as allowed by law to July 18, 1947 in the sum of $341.97, totaling the sum of $837.58 and with interest thereafter at the rate of 1% a month as provided by law on the aforesaid principal sum of $495.61 from July 18, 1947 to the date of payment, and for New York City business taxes in the sum of $19.72 with interest as allowed by law to July 18, 1947 in the sum of $13.13, totaling the sum of $32.85 and with interest thereafter at the rate of 1% per month as provided by law on the principal sum of $19.72 up to the date of payment of said claim, as claims entitled to priority under Section 64a(4) of the Bankruptcy Act, and the Referee having thereafter duly issued a certificate on said petition to review, and the same having duly come on for hearing before the undersigned on the 5th day of November, 1947.

Now, upon reading and filing the certificate of Hon. John E. Joyce, Referee in Bankruptcy, dated October 23, 1947, together with the exhibits and documents referred to there-[fol. 37] in, and after hearing David Haar, attorney for the trustee in support of said petition to review, and Charles E. Murphy, Esq., Corporation Counsel of the City of New York, by Leroy Mandle, Esq., of counsel, in opposition thereto, and upon filing the opinion of the undersigned dated December 1, 1947, and due deliberation having been had thereon, and good and sufficient reason appearing therefor, it is

On motion of Charles E. Murphy, Corporation Counsel of the City of New York, attorney for the claimant herein.

Ordered, that the said petition to review the order of Hon. John E. Joyce, Referee in Bankruptcy, dated September 23, 1947, be and the same is hereby dismissed; and it is further

Ordered, that the order of Hon. John E. Joyce, Referee in Bankruptcy, dated September 23, 1947, be and the same is hereby in all respects affirmed, and the claim of the City of New York for sales taxes in the sum of $495.61 with interest as allowed by law to July 18, 1947, in the sum of $341.97 and with interest thereafter as provided by law at the rate of 1% a month on the principal sum of $495.61 from July 18, 1947 to the date of payment thereof and for New York City business taxes in the sum of $19.72 with interest as allowed by law to July 18, 1947 in the sum of $13.13 and with interest as provided by law at the rate of 1% per month on the principal sum of $19.72 to the date of payment of said claim be and the same hereby is allowed as claims entitled to priority under Section 64a(4) of the Bankruptcy Act.

Alfred C. Coxe, U. S. D. J., A. C. C.

[fol. 38] In United States District Court, Southern District of New York

#83,203

In the Matter of Spotlight Productions, Inc., Bankrupt; Lewis H. Saper, as Trustee in Bankruptcy of Spotlight Productions, Inc., Appellant, vs. Lazarus Joseph as Comptroller of The City of New York, Appellee

Notice of Appeal

Sir:

Please take notice that Lewis H. Saper, as trustee in bankruptcy of Spotlight Productions, Inc., hereby appeals to the United States Circuit Court of Appeals, for the Second Circuit, from an order made in the District Court on the 9th day of December, 1947, insofar as it affirms the order of Hon. John E. Joyce, Referee, permitting the payment of interest from the date of the filing of the petition as such, and also as a priority, and the trustee also appeals from so much of said order as affirms the order of the Referee allowing the claim of The City of New York for taxes on purchases made by the bankrupt, and the trustee appeals from

[fol. 39] each and every part of such portions of the order as indicated above.

Dated, New York, January 5th, 1948.

Yours, &c., David Haar, Attorney for Appellant, 270 Broadway, New York City.

To: John P. McGrath, Esq., Corporation Counsel, Attorney for City of New York, Appellee, Municipal Building, New York City.

[fol. 40] In United States District Court

[Title omitted]

Stipulation as to Record

It is hereby stipulated and agreed that the foregoing is a true transcript of the record of the said District Court in the above entitled matter as agreed upon by the parties.

Dated, New York, February 20th, 1948.

David Haar, Attorney for Appellant; John P. McGrath, Corporation Counsel, Attorney for Appellee.

[fol. 41] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 42] UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 267—October Term, 1947

(Submitted May 3, 1948. Decided May 25, 1948.)

Docket No. 20977

LEWIS H. SAPER, as Trustee in Bankruptcy of Spotlight Productions, Inc., Petitioner-Appellant,

v.

THE CITY OF NEW YORK, Respondent-Appellee

Before L. Hand, Swan and Clark, Circuit Judges

Appeal from the District Court of the United States for the Southern District of New York

Petition by Lewis H. Saper, as trustee of Spotlight Productions, Inc., bankrupt, for review of an order of a referee in bankruptcy refusing to expunge the claim of the City of New York against the bankrupt for sales and business taxes and ordering the payment of the claim, together with interest at the rate of one per cent per month until the date of payment. From an order affirming the [fol. 43] order of the referee, D. C. S. D. N. Y., 75 F. Supp. 458, the petitioner appeals. Order affirmed as to the principal of the taxes, but reversed as to the interest.

David Haar, of New York City, for Appellant; John P. McGrath, Corp. Counsel, of New York City (Isaac C. Donner, Bernard H. Sherris, and Leroy Mandle, all of New York City, of counsel), for Appellee.

Clark, Circuit Judge:

The first point on this appeal concerns the validity of a claim against an estate in bankruptcy for certain sales and business taxes levied by the City of New York against the bankrupt. The trustee concedes the validity of such taxes as were levied upon the bankrupt's sales of machinery

manufactured by it, but contests the tax levied on its purchases of materials. But, as stated in the opinion below, D. C. S. D. N. Y., 75 F. Supp. 458, this is directly contrary to the law and the rulings under it. It is quite settled that both seller and purchaser may be held liable for the city sales tax, though in fact it is primarily imposed upon the purchaser, who must pay it to the City Treasurer if he has failed to pay it to his vendor. § N41-2.0, subds. e, f, of the Administrative Code, New York City. *Kosbeck, Inc.* v. *McGoldrick*, 278 N. Y. 293, 297, 16 N. E. 2d 288, 119 A. L. R. 536, reargument denied 278 N. Y. 716, 17 N. E. 2d 136; *Fifth Ave. Bldg. Co.* v. *Joseph*, 272 App. Div. 449, 71 N. Y. S. 2d 566; *City of New York* v. *Feiring*, 313 U. S. 283. The liability of the estate is clear.

The other point, however, the liability of the estate for interest upon these tax claims after bankruptcy and until [fol. 44] they are paid, is interesting, important, and difficult. Both the referee and the district court have allowed interest, at the high rate provided by the local code of one per cent per month, so that the accumulating interest is fast approaching the face of the claim.[1] The decison must affect all tax claims in bankruptcy, from those of the federal government to those of any state or subdivision thereof. The matter has been in dispute and must remain so until settled by the Supreme Court. As will appear, the members of this court are not in accord as to the result to be reached. The court as presently constituted is agreed that Judge Coxe's decision, D. C. S. D. N. Y., 75 F. Supp. 458, should be reversed. His decision, however, was in accord with *Davis* v. *Green*, 1 Cir., 133 F. 2d 451 (which had reversed a referee and a district judge), and has the support of some other district court opinions, *e.g.*, *In re Flagton*, D. C. E. D. N. Y., 42 F. Supp. 1002; and *cf. In re L. Gandolfi & Co.*, D. C. S. D. N. Y., 42 F. Supp. 706. It is contrary to the decision of Judge Bright in *In re Union Fabrics*, D. C. S. D.

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[1] The tax period involved was Nov. 1, 1940 to May 31, 1942; the petition in bankruptcy was filed Jan. 5, 1944, and the City's claim originally on May 19, 1944; the referee's order of allowance was made on July 18, 1947. In that order he allowed a sales tax of $495.61, with interest to date of $341.97, and a business tax of $19.72, with interest of $13.13, and made express provision for additional interest at the rate of 1% per month until payment.

N. Y., 73 F. Supp. 685, the appeal from which is decided herewith,[2] with the writer of this opinion alone of the court there sitting in agreement with Judge Bright. Our decision herein was perhaps somewhat foreshadowed by the remarks of Judge L. Hand in *Hammer* v. *Taffa*, 2 Cir., 145 F. 2d 447, 449, leaving the question open, and by those of Judge Swan in *United States* v. *Roth*, 2 Cir., 164 F. 2d 575, pointing out that under the recent congressional enactments tax claims [fol. 45] were treated substantially as debts of the bankrupt. It is in accord with the views of text writers, notably Messrs. Moore and Oglebay, 3 Collier on Bankruptcy, 14th Ed. 1941, ¶ 63.16, reiterated in 1946 Cum. Supp. 131, 132, also Mr. Oglebay in 17 J. N. A. Ref. Bankr. 127, 129, 130, 21 *id.* 106, 107, 22 *id.* 41, and the commentator in 61 Harv. L. Rev. 354.

For reasons both of administrative convenience and of fundamental justice and equity it has been steadily held, following the English practice, that interest does not accrue upon claims during the period of bankruptcy administration.[3] *Sexton* v. *Dreyfus*, 219 U. S. 339, 344; *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 163, 165; 3 Collier, *loc. cit. supra*. A single exception, that for tax claims, was developed judicially. It appears to have begun with *In re Kallak*, D. C., N. D., 147 F. 276, though the contemporaneous case of *In re William F. Fisher & Co.*, D. C. N. J., 148 F. 907, held to the contrary. But the *Kallak* case set the pattern and was followed by other cases, including *In re J. Monsif & Co.*, 2 Cir., 290 F. 947, which, however, allowed interest only at the legal rate. When the Supreme Court reversed this holding to allow interest at the statutory rate, though without separate discussion of our particular problem, *United States* v. *Childs*, 1924, 266 U. S. 304, the matter was considered settled. The reason for the rule was that the original Bankruptcy Act treated tax claims quite differently from other debts; instead of requiring their presentation in due course, it provided that "the court shall order the trustee to pay all taxes

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[2] *Carter, Trustee* v. *United States et al.*, 2 Cir., — F. 2d —.

[3] If, however, a sufficiency of assets develops, the claims will bear interest; and though the usual rule applies also to secured claims, yet where the security itself yields interest, or dividends, those are applicable to interest on the claims. 3 Collier, *loc. cit. supra*.

legally due and owing by the bankrupt to the United States, [fol. 46] State, county, district, or municipality in advance of the payment of dividends to creditors." § 64a, 11 U. S. C. A. § 104(a) (before amendment). Hence the trustee was, in effect, compelled to search them out. So taxes were in altogether a separate class; they were to be paid before any administration of the estate, properly speaking, and thus had an absolute priority over the bankrupt's debts. In view of this peculiarly favored position, the like result as to interest was certainly not unnatural, even if not compelled.

In 1926, however, § 64a was amended, by adding the words "in the order of priority as set forth in paragraph (b)"; and of the seven priorities provided in (b), taxes came sixth or next to the last. Even that change might have been considered sufficient to reduce taxes to the status of debts in view of the obvious doubt as to the payment of interest upon a sixth claim in a series where the earlier five admittedly carried none. Moreover, § 64b spoke of the debts "to have priority" in advance of the payment of dividends to creditors, "and to be paid in full out of bankrupt estates," in the order then stated; it was at least odd to think that a wage claim up to $600 was "paid in full" when paid without interest, whereas a tax claim of later priority was not so paid until interest of 12 per cent or more was included.[1] But the issue did not come before the Supreme Court; and apparently the lower federal courts continued their former practice. *Cf. Horn* v. *Boone County, Neb.*, 8 Cir., 44 F. 2d 920; *In re Simon*, D. C. Conn., 11 F. Supp. 18, modified on other grounds 2 Cir., 80 F. 2d 81.

At any rate the process of assimilation of tax claims to other debts appears, to us at least, to have been completed by the Chandler amendments of 1938. Indeed we thus described the changes in *United States* v. *Roth*, *supra*, 164 F. [fol. 47] 2d at pages 577, 578: "By the 1938 amendments, however, taxes were classified as 'debts' within section 64, sub. a, 11 U. S. C. A. § 104, sub. a, and section 57, sub. n, 11 U. S. C. A. § 93, sub. n, was broadened to include 'all claims of the United States' and require them to 'be proved

[1] For the meaning of "paid in full" as limited to the principal, see *Hagaman* v. *Tufts*, *supra*, 145 F. 2d at page 449.

and filed in the manner provided in this section." Subdivision a of section 57, 11 U. S. C. A. § 93, sub. a, provides that a proof of claim shall state among other matters "that the claim is justly owing from the bankrupt to the creditor"; * * * Thus it is apparent that the Act, as it now stands, treats the tax claim as a debt and the United States as a creditor which, like other creditors, must make proof of claim on a form" prescribed by the Supreme Court. Thus, then, took from tax claims their former favored position where no proof or other governmental action was necessary for their enforcement. Thenceforth they must be proved, or otherwise be barred, just like other debts of the bankrupt.

We see no reason to suppose that this did not place tax claims in the same situation as other debts with respect to interest also. The chief ground taken in *Daze* v. *Green*, *supra*, and the other cases which argue for the priority of interest, as well as principal, though conceding its inequity, [fol. 48] is that Congress by failing to exclude it has re-enacted the old rule. It is dubious at best to rely upon such congressional adoption where "a close scrutiny of the various reports and hearings on the Chandler Act or its predecessor bills reveals nothing to indicate that the prob-

* In addition, by these amendments the priority subdivision formerly § 64b became § 64a, and the classes of priorities were changed to five instead of seven, the status of tax claims being still next to the last or (4) instead of (6). This was no advancement in position, since former classes (1), (2), and (3) were combined with (1). In 1946, there was added to (1) "the fees for the referees' salary fund and for the referees' expense fund." [This note is not a part of the quotation.]

" By making a tax claim a debt of the bankrupt it is brought within the terms of § 63a, 11 U. S. C. A. § 103(a), defining provable debts, of which subd. (1) allows interest only up to the filing of the petition, and subd. (5) includes provable debts reduced to judgment after filing, but less costs incurred and interest after the filing. Hence under subd. (5), when a tax claim is reduced to judgment after the filing, interest must be deducted. This points up the anomaly of another rule for tax claims not reduced to judgment.

lem was ever under consideration." 3 Collier on Bankruptcy, 1946 Cum. Supp., at n. 28a of ¶ 63.16; 61 Harv. L. Rev. 354. But it is submitted with deference that the pinch is on the other foot. When Congress provided that taxes must be proven like other debts and put them in, and well down in, a hierarchy of other claims, none of which bore interest, we think that like treatment was intended unless some specific exception was stated. This seems all the more likely when we recall the dubious and uncertain history of the original judicial exception.

This conclusion seems to us fortified by arguments of practicality and convenience—if not of equity, as stressed by Judge Bright—which would naturally appeal to legislators or draftsmen, if a careful exploration of the subject is to be attributed to them. Of course, the allowance of accruing interest to the various state and governmental units "would necessitate constant rescheduling and recomputation of dividends available." 61 Harv. L. Rev. 354, 355. And the net result will be to promote tax claims beyond what seems the clear intent of the statute.[7] Moreover, with the very heavy interest rates now collected by states and municipalities and upheld in *Meilink* v. *Unemployment Re-*
[fol. 49] *serves Commission of State of California*, 314 U. S. 564, it is apparent that any bankrupt estate whose settlement is delayed for any period of time is likely to be eaten up by the accruing interest on the various taxes now levied against business enterprises. As Referee Hunt points out, 17 J. N. A. Ref. Bankr. 121, 122, no trustee can afford to resist any tax claims, even with proper defenses. With interest accruing thus rapidly, he must settle at once and stop the increase in amount. True, it is suggested that this will be a boon to failing debtors who otherwise might

[7] Assume a bankrupt to owe $1,000 to an employee for wages, $1,000 each to three taxing authorities, and $1,000 for rent given priority under state law. Under ¶ 64a, which gives priority to the amount of $600 for wages and allows the others in order, these would be all paid in full if the assets were $5,000 and there were no other general claims beyond the $400 balance on the wage claim. But with interest allowed on the tax claims at 12% (or perhaps more) per annum, during the bankruptcy, possible payments on the later claims would diminish in size as rapidly as Alice in Wonderland.

be forced to the wall by rapacious tax collectors driven to precipitous action because the claims do not bear interest. But this is based upon an assumption both of alertness upon the part of taxing officials and of the importance of this lone item in the tax structure of municipalities and the state and federal governments which seems to us to have little connection with reality.

Two further arguments of claimants must be noted. One is as to § 57j, an old provision of the law stating that debts owing the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained "and such interest as may have accrued thereon according to law." Whether this has any meaning beyond the penalty or forfeiture cases we do not need to consider, for it seems clearly to be operable only *after* the question as to what, if any, interest is legal has been decided.[8] The other is that, since [fol. 50] tax claims, if unpaid, are not discharged in bankruptcy, then the unpaid interest on tax claims will survive against the bankrupt even after payment of the tax claims themselves. No cases appear yet to have held that interest thus survives beyond the principal claim which gives it birth. But assuming *arguendo* that interest is not discharged upon payment of the tax claim, we do not see how that fact can be decisive on the present issue. When the Chandler Act was under consideration, the House bill made taxes dischargeable, while the Senate amendment retained existing law. Sen. Rep. No. 1916, 75th Cong., 3d Sess., 4, stated that the committee felt "that if Federal taxes were made dischargeable, it would open the door to evasion. The Treasury Department recommended against the House amendment." Thus this was done to protect the revenue,

[8] In the companion case, the United States devotes much attention to various of the federal revenue laws and congressional debates as to changes in them with respect to interest against estates held by fiduciaries. But these do not offer any clear-cut solutions in themselves and are hardly available to change the stated priorities of a bankruptcy act. Obviously the intent of the latter is to treat federal, state, and municipal tax claims alike; it would be quite improper to accord the former alone some advantage based upon some newly discovered other federal law or regulation.

and consideration for, or against, the bankrupt was not an issue. The fact that the bankrupt may not have received an immunity he might desire is not ground for upsetting the statutory scheme of distribution of the estate in the hands of the trustee. The point is academic here—as it will often be—since the bankrupt is a corporation whose existence will be brought to an end by the bankruptcy.

Accordingly the order on appeal will be affirmed to the extent that it refuses to expunge the tax claims, but will be reversed so far as it allows interest after the filing of the petition on January 5, 1944.

Order affirmed in part and reversed in part.

[fol. 51] UNITED STATES CIRCUIT COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 25th day of May one thousand nine hundred and forty-eight.

Present: Hon. Learned Hand, Hon. Thomas W. Swan, Hon. Charles E. Clark, Circuit Judges.

In the Matter of SPOTLIGHT PRODUCTIONS, INC., Bankrupt; LEWIS H. SAPER, as Trustee, etc., Appellant; LAZARUS JOSEPH, as Comptroller, etc., Appellee

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed to the extent that it refuses to expunge the tax claims; but reversed with costs so far as it allows interest after the filing of the petition on January 5, 1944, in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

Alexander M. Bell, Clerk.

[fol. 52] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. In re Spotlight Productions, Inc., Lewis H. Saper, as Trustee, etc., Lazarus Joseph, as Comptroller, etc. 267. Judgment. United States Circuit Court of Appeals, Second Circuit. Filed May 25, 1948. Alexander M. Bell, Clerk.

[fol. 52] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 54] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 11, 1948

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on Cover: Enter John P. McGrath. File No. 53,170. U. S. Circuit Court of Appeals, Second Circuit. Term No. 168. The City of New York, Petitioner, vs. Lewis H. Saper, as Trustee in Bankruptcy of Spotlight Productions, Inc. Petition for writ of certiorari and exhibit thereto. Filed July 21, 1948. Term No. 168 O. T. 1948.